Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Arambula	Analyst:	Nicole Kwon	Bill Number:	AB 1506
Related Bills:	See Legislative History	Telephone:	845-7800	Introduced and Amended Dates:	February 23, and April 19, 2007
		Attorney:	Dan Biedler	Sponsor:	

SUBJECT: Qualified Capital Greenhouse Gas Emissions Reduction Equipment Credit/Energy Independence And Early Adapter Business Incentive Act Of 2007

SUMMARY

This bill would create a tax credit for qualified capital equipment used to reduce greenhouse gas emissions.

This bill would also amend some provisions of the Corporations Code and the Government Code relating to business loans; however, those provisions do not apply to the Franchise Tax Board (FTB), and this analysis addresses only those provisions of the bill affecting FTB.

SUMMARY OF AMENDMENTS

The April 19, 2007, amendments made minor changes to the definitions for “qualified capital equipment” and “qualified facility.” The April 19, 2007, amendments also changed the qualified equipment placed in service date from March 1, 2008, to January 1, 2008, and made minor nonsubstantive changes. All other provisions in the April 19, 2007, amendments are same as to the bill introduced on February 23, 2007.

This is the department’s first analysis of the bill.

PURPOSE OF THE BILL

According to the legislative intent language of the bill, the purpose of this bill is to encourage businesses to purchase new equipment resulting in lower greenhouse gas emissions and increasing market for new products, services, and processes.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2008, and would apply to taxable years beginning on or after that date.

POSITION

Pending.

Board Position:			Department Director	Date
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ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Previous state law allowed qualified taxpayers a Manufacturers' Investment Credit (MIC) equal to 6% of the qualified costs paid or incurred on or after January 1, 1994, and before January 1, 2004, for qualified property that was placed in service in California.

For purposes of the MIC, a qualified taxpayer was any taxpayer engaged in manufacturing activities described in specified codes listed in the Standard Industrial Classification (SIC) Manual, 1987 edition. Qualified property was any of the following:

1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code (IRC) and used in a qualified SIC Code activity, that is used primarily for:
   - manufacturing, processing, refining, fabricating, or recycling of property;
   - research and development;
   - maintenance, repair, measurement, or testing of otherwise qualified property; or
   - pollution control that meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) Special purpose buildings and foundations that are an integral part of specified activities.

For taxpayers engaged in computer programming and computer software-related activities, qualified property included computers and computer peripheral equipment used primarily for the development and manufacture of prepackaged software and the value of any capitalized labor costs directly allocable to such property.

The MIC explicitly excluded certain types of property from the definition of qualified property, such as furniture, inventory, and equipment used in an extraction process.

The MIC statute was repealed by its own terms and ceased to be operative as of January 1, 2004, due to the number of manufacturing sector jobs in California no longer meeting the MIC statutory requirements.

THIS BILL

This bill would provide, for each taxable year beginning on or after January 1, 2008, and ending by January 1, 2012, a 10 % credit for amounts paid or incurred for qualified capital equipment under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL).

This bill would define "qualified capital equipment" to mean equipment that, when properly installed, produces a measurable reduction in the qualified facility's greenhouse gas emissions, and that meets all of the following requirements:

- Be placed in service and used exclusively in California,
- Be certified by the California Climate Action Registry or the state Air Resources Board that it has been properly installed in a qualified facility and is operational, and
- Be certified by the California Climate Action Registry or the state Air Resources Board that its operation will result in measurable reductions in greenhouse gas emissions.

This bill would define a "qualified facility" to be either of the following:

- An existing facility of the taxpayer, or
- The expansion of an existing facility, either in the same location or adjacent to an existing facility of the taxpayer.

This bill would define the "state board" to mean the State Air Resources Board.

This bill would specify that a taxpayer may claim a credit for a prorated share of the total cost of the equipment based on the additional greenhouse gas reduction value of the equipment.

This bill would specify that credits may be claimed on qualified equipment placed in service in a qualified facility on or after March 1, 2008.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill is silent about whether the property must be purchased "new" or whether used property would also qualify. Because the credit is not limited to new property, the original use of which commences with the taxpayer, taxpayers could sell the property among affiliates and, absent any kind of recapture provision, continually generate new credits. The author may wish to add a recapture mechanism that requires the taxpayer to use the qualified property for a minimum period in order to qualify for the credit.

The definition for “qualified capital equipment” does not contain a requirement that the equipment be capitalized to qualify for this credit. If the author’s intention is to restrict the type of equipment that may qualify as capital equipment, a definition for “capital” should be added.

If the author’s intention is to allow leasing transactions of qualified capital equipment to qualify for this bill's provisions, it is suggested that the bill provide rules regarding lease transactions.

The bill specifies that a taxpayer may claim a credit for a “prorated shared of the total cost of the equipment based on the additional greenhouse gas reduction value of the equipment.” The bill, however, is silent about how the “additional” greenhouse gas reduction value of the equipment should be measured. The author’s office may want to clarify how this reduction can be measured for the department to administer the provisions of the bill.

The phrase “ending by January 1, 2012” on page 5, line 11 and page 6, line 36, would mean that fiscal year taxpayers with tax years ending after January 1, 2012, will not be able to claim the credit provided in this bill for their 2011 fiscal year. It is suggested that author’s office replace “ending by January 1, 2012” with “on or after January 1, 2012” to resolve this issue.

LEGISLATIVE HISTORY

AB 811 (Levine, 2007/2008) would authorize a credit for amounts paid or incurred for the construction of an eligible renewable resource. AB 811 is scheduled to be heard in the Assembly Revenue & Taxation Committee on May 7, 2007.

AB 2924 (Arambula, 2005/2006) would have allowed three new credits for certain capital expenditures and also would have permitted accelerated depreciation of the expenditures. AB 2924 was held in the Assembly Revenue & Taxation Committee.

AB 2553 (Arambula, 2005/2006) would have allowed a credit for amounts paid for qualified capital expenditures and allow a taxpayer to depreciate those qualified capital expenditures over three years. AB 2553 was held in the Senate Appropriations Committee.

AB 2595 (Arambula, 2005/2006) would have allowed a taxpayer to depreciate qualified manufacturing equipment. AB 2595 was vetoed by the Governor.

FISCAL IMPACT

This bill would require a calculation for the credit that would require a new form or worksheet to be developed. The department's costs to administer this bill cannot be determined until implementation concerns have been resolved, but are anticipated to be minor.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB1506 As Amended 4/19/07 [$ in Millions]		
2007-08	2008-09	2009-10
-$10	-$50	-$85

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of the bill would be determined by the amount expended for qualified capital equipment, and the amount of credits applied to reduce tax liabilities.

According to the Annual Survey of Manufactures, California businesses spent $11.2 billion on new and used machinery and equipment in 2005. This level of investment for 2005 is grown to years 2008 through 2010 by the projected growth in corporate profits as forecasted by the Department of Finance. At the 2008 level, the level of investment is estimated at $13.6 billion.

For purposes of an estimate, it is assumed that one-quarter of the $13.6 billion is for qualified capital equipment as specified in the bill, or $3.4 billion ($13.6 billion x 25% qualified equipment = $3.4 billion).

Eligible greenhouse gas reductions do not include that required by law or regulation. Currently, not one industry group is required to reduce greenhouse gas emissions. As requirements are established in coming years, qualified capital equipment otherwise eligible for the credit will become ineligible. Beginning with 2009, qualified capital equipment eligible for the proposed credit is reduced by 3% to reflect required greenhouse gas emission reductions imposed on vehicle manufacturing businesses.

Additionally, the bill specifies that the credit only applies to persons and entities that report their greenhouse gas emissions to the California Climate Action Registry or the ARB. At present, all reporting is on a voluntary basis. It is assumed that one-third of qualified capital equipment would be eligible for the credit in 2008, or $1.1 billion ($3.4 billion x 1/3 = $1.1 billion).

Applying the credit percentage of 10% to the remaining qualified capital equipment expenditures results in credits generated of $110 million for 2008 ($1.1 billion x 10% = $110 million). It is assumed only half of the credits generated would be applied in the year generated, or about $55 million for the 2008 taxable year. Carryover credits are assumed applied over the succeeding five-years. Taxable year estimates have been converted to cash flow fiscal year estimates in the table above.

POLICY CONSIDERATION

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned

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